# A People's Bank

**Australia's financial sector is defined by the power of the big-four banks, the money they make off housing loans and their billion dollar annual profits to shareholders. In the face of ongoing misconduct and price gouging, it's time for Government to step in and ensure that there is a low-cost banking service, backed by the RBA, that is focused on the everyday savings and mortgage needs of customers.**

## BIG BANKS HAVE FAILED US

Australia's banking system is currently under the microscope after an overwhelming stream of scandals and misconduct was coupled with parliamentary pressure led by the Greens, forcing the government to finally establish a Royal Commission into the banking sector in 2017. The first round of hearings has been explosive. Already we've seen evidence of widespread lending fraud[1], and this is expected to be just the tip of the iceberg.

At the same time, the ACCC[2] and the Productivity Commission[3] have been investigating competition within the sector. Their findings demonstrate what The Greens and experts have been saying for years: that three decades of deregulation and privatisation has left us worse off, not better. The big-four banks continue to dominate the market and are generating super profits for shareholders off the backs of ordinary Australians who are struggling to meet the cost of their mortgages. They charge hefty interest rate margins up to three to four times over and above the wholesale cash rate they themselves access from the Reserve Bank.

### THE PEOPLE'S BANK

**To inject real competition, create jobs and focus on home-buyers not shareholders.**

Imagine a bank whose real goal was to serve its customers, not line its shareholders' pockets. The Greens will use the Reserve Bank of Australia (RBA) to establish a People's Bank to provide basic low-risk banking services to the public.

At the People's Bank, everyday Australians would be able to establish accounts directly with the RBA for day-to-day banking facilities.

Customer service would be provided online, by telephone, or face-to-face through Australia Post and other partners. Everyday banking for public good, not profit margins!

Products provided to the public by the People's Bank would be:

- Savings accounts pegged to the RBA cash rate, with debit cards linked to these accounts also available.
- Mortgage tracker accounts pegged to the RBA cash rate (see further detail below).

People banking with the People's Bank can also have confidence that their savings won't be used for inappropriate investments, such as new coal mines.

---

1 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Public Hearings: Round 1

2 ACCC, Residential mortgage price inquiry – Interim Report, March 2018.

3 Productivity Commission, Competition in the Australian Financial System – Draft Report, January 2018.

Authorised by R Di Natale for the Australian Greens, Parliament House, Canberra ACT

All of this is taking place as the actual cost of running a bank and moving money has been dramatically reduced by advances in technology. The big banks are able to do this with the benefit of regulations that support their too-big-to-fail status, and with implicit and explicit government guarantees for which they do not pay the full price.

Basic banking is an essential service that should not be used as a vehicle to underwrite risky activity, or to further concentrate wealth and exacerbate inequality. The Greens have a plan to put an end to the rent-seeking and profit gouging, by stepping in with a government backed bank that offers a real alternative for everyday personal banking and home buyers.

## LOW COST MORTGAGES FOR HOME-BUYERS

Nowhere is the destructive impact of the current status quo more evident than in the housing sector, where sky-high house prices in most big cities demonstrate how our housing market has been rigged to lock out first-home buyers, with the Big Four banks raking in huge dollar profits for more than a decade.

Since the Global Financial Crisis, the average gap (spread) between the RBA cash rate and standard mortgages interest rates has almost doubled from just below 2% to now just below 4%[4]. This is, in part, due to increased capital holding requirements. But it is also because banks have benefited from a tax system that enables property investors to deduct interest expenses.

Negative gearing and the capital gains tax discount have not only pushed house prices into the stratosphere, they have become one more way for the banks to siphon off your hard-earned money. Combined with increased leveraging off the securitisation of mortgages, tax breaks for housing encouraged a dramatic shift in lending by Australian banks into unproductive speculation on land.

***Worked example***

Sam and Ashley have saved $90,000 for a deposit to buy their first home. They settle on a house in Pleasantville for $600,000. The People's Bank will lend them 60% of the value of the home, which equates to $360,000. They'll then need to borrow a further $150,000 from a retail bank.

| | |
|---|---|
| House price | $600,000 |
| Deposit | -$90,000 |
| Loan requirement | $510,000 |
| People's Bank (60% x $600,000) | $360,000 |
| Retail Bank | $150,000 |

Comparing a retail loan for the full $510,000 at 4.5% with a combined People's Bank loan at 3.5% and retail loan at 4.5%, if the monthly repayments were the same ($2,834.75 per month) the combined loan would be paid off 3 years and 4 months sooner and would save Sam and Ashley $113,102 in interest.

**Combined loan: Paid off in 21 years 8 months; total interest paid $227,311**

**Retail loan: Paid off in 25 years; total interest paid $340,413**

*Assuming a People's Bank rate of 3.5%, stable retail rate of 4.5%.*

Thirty years ago, business lending was double that of property lending. Now it's the other way around. It's off the back of housing that the banks continue to make enormous profits and continue to pay extraordinarily generous dividends to shareholders. We have to stop encouraging the banks to gamble with our money and our economic well-being. The People's Banks will address the problems of interest rate spread and unproductive investor speculation head-on by offering a no-frills 'mortgage tracker' account to homeowners.

[4] Productivity Commission, 2018, ibid

People paying off their home will be able to borrow up to 60% of the value of the property directly from the RBA. The interest rate would be set at a minimum of 3.0%, plus an administration fee of approximately 0.5% for service provider partners. The base rate would go up with the cash rate if it rises above 3.0%. i.e. if the cash rate was 3.5%, the loan rate would be 4%.

Giving ordinary Australians a direct line to the RBA will provide current and future home owners a much needed advantage over investors. This, in turn, will help turn around the drastic decline in homeownership rates. It will also force the banks to provide a public benefit, instead of distorting the economy and loading up the financial system with risk. Homeowners needing to borrow more than 60% of the value of the property would borrow the rest from retail banks. In practice, many people will stay with their existing bank as they either pass through that component of the loan taken directly from the RBA, or match the People's Bank's interest rate with their own 'mortgage tracker' account. Encouraging competition is at the heart of the Peoples Bank's mission.

## CURRENT LOAN RATES AT THE BIG 4 BANKS

Best publicly available variable 'interest plus principle' mortgage rates (excluding fees) as 2 April 2018 on the big-4 websites are:

| | | |
|---|---|---|
| ANZ | Simplicity Plus | 4.55% p.a. |
| NAB | Tailored Home Loan | 5.24% p.a. |
| CBA | Standard Variable Rate | 5.22% p.a. |
| Westpac | Flexible First Option | 4.59% p.a. |
| RBA Cash Rate +0.5% (3% floor) | "The People's Bank" mortgage tracker | 3.5% p.a. |

## MANAGING MORTGAGE TRACKER RISKS

Mortgage tracker accounts would only be available to people with no other direct residential property holdings, including through self-managed superannuation funds (SMSFs) and private trusts. This is so as to prevent people gaming the system by using the People's Bank to cross-collateralise investment properties. It's already easy enough for Baby Boomers to buy their fifth rental property - the role of the People's Bank's isn't to make it easier still.

The People's Bank would also be subject to strict lending standards that require a genuine evaluation of capacity to pay and that take into account a mortgagee's proximity to retirement. Restricting public lending by the RBA to a loan-to-value ratio (LVR) of 60% ensures that the risk to the public is minimised. The People's Bank would have first call on the proceeds of the sale of a property in the result of a mortgage default, meaning that retail banks who lend any additional amount will carry nearly all of the risk.

The amount able to be borrowed through the People's Bank would be capped at $500,000 for owner-occupiers. Repayment terms would be principal and interest over a maximum of 30-years.

## LEVELING THE PLAYING FIELD FOR CREDIT UNIONS & CO-OPS

The establishment of People's Bank would be a major first step towards reforming the banking sector, but it is not enough on its own. The Greens are calling for a number of additional reforms to promote competition in the banking sector, because any reform should encourage a contest between different models of banking.

As well as disrupting the price gouging of the big banks through the provision of more transparent, lower cost everyday and mortgage services, The Greens will level the playing field to ensure that credit unions and co-ops are able to offer comparable services - effectively reversing decades of regulation through which the big banks have re-written the rules to suit themselves and lock out alternatives that threatened their market share. In particular, credit unions and customer owned banks continue to be restricted in their use of the words 'bank' and 'banking'. This curtails their ability to advertise their services and to educate the public. Restrictions around the use of 'banking' terms should be removed so that all authorised deposit taking institutions (ADIs) are on a level playing field.

The bank levy format also privileges big banks who are "too big to fail" over smaller alternative models of banking. The Major Bank Levy introduced by the government is well designed in that it is limited to the major banks. However, the rate of six basis points per annum is not enough. The lower bound of the RBA's estimate of the wholesale funding advantage received by the big banks for being too-big-to-fail is 20 basis points[5].
The Major Bank Levy should be increased to this amount so that the public is adequately compensated for the cost of insuring the major banks.

Non-major banks continue to be disadvantaged by regulations that restrict their lending and business activities. APRA permits major banks to determine their own risk rating for capital holdings against mortgages. This gives them an estimated 15 basis point advantage over non-major banks. The Royal Commission has highlighted widespread problems within the major banks' lending records that would indicate their record keeping system is not so advanced as to warrant a regulatory advantage. Regulatory standards regarding mortgage risk weights should be reformed so as to better reflect the actual risk of a bank's portfolio, and to close the gap between major banks and non-major banks.

## HELPING CUSTOMERS VOTE WITH THEIR WALLETS

Banks rely on it being "too hard" for customers to move their accounts. However, the modern digital age enables us to conduct "identity transfer" relatively easily. This portability should be extended to the banking sector. People can carry mobile phone numbers from one provider to another. The same option should be available to consumers in banking. Full account portability—or 'open banking'—should be introduced as soon as possible. This would include a common data system for banking that gives customers ongoing ownership of their data as well as the ability to shift seamlessly and safety from one provider to another.

5 RBA, Parliamentary Briefing, Implicit Guarantees for Banks, 2012.

## NEW ERA OF ACTIVE GOVERNMENT INTERVENTION

The people's bank is just one way in which we can reverse the impact of decades of privatisation and deregulation have had on our community and our economy. The Greens are not afraid to call out the trickle-down economic hoax for what it is, and to advocate for active government intervention in areas of our economy that are focused on maximising shareholder profits and CEO bonuses at the expense of our community and our environment.